

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 4, 2008

Issue 202

## Market Overview

*Summary of Recent Active Studies (see <http://QuantifiableEdges.blogspot.com> or Letters from listed dates for details)*

Study Date	Description	Time span	Bias	Avg Max Move	Avg MM + 1 Std Dev
December 4, 2008	2 Days Up In Chop	1-3 days	Bearish	-1.50%	-3.20%
December 4, 2008	Gap Down & Reverse	1-2 days	Bearish	-2.60%	-5.20%
<b>December 2, 2008</b>	<b>5% Drop</b>	<b>1-4 days</b>	<b>Bullish</b>	<b>5.30%</b>	<b>8.50%</b>
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish		

If the avg max move is achieved it will appear in **bold and brown**. If the avg + 1 std deviation is achieved, the study will in *bold italic blue* and will be removed tomorrow.

### *Short-term Outlook (1-5 days) –slightly bearish – updated 12/4*

After a large gap down of over 2%, the market did an about face and closed more than 2% above yesterday's close. Breadth was strong. Up issues outnumbered down issues by about 2 to 1 and up volume came in greater than down volume by about 4 to 1. Total volume rose a little but still wasn't much above average.

For the market to gap so low and then close so high is unusual. There have only been 3 other times where SPY has gapped lower by 2% in the morning and then closed over 2% above yesterday's close. They were 10/28/97, 7/24/02, and 1/23/08. All three marked temporary bottoms for the market. In each case the SPY pulled back in the next day or two to close below the close of the instance day. In each case it then launched higher as well. This is the first time the formation has happened when the SPY wasn't within a day of the low.

I loosened the criteria by adjusting the level of the gap and the close higher. Looking out two days we see the following results:

SPY gaps lower by X% and then closes at least X% above yesterday's close.												
Buy on close. Sell X days later. \$100k/trade. 1994-present.												
X%	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
2	(\$2,050.38)	3	1	2	33.33	\$1,042.80	(\$2,480.64)	\$1,042.80	(\$1,546.59)	0.67	0.34	(\$683.46)
1.75	(\$2,050.38)	3	1	2	33.33	\$1,042.80	(\$2,480.64)	\$1,042.80	(\$1,546.59)	0.67	0.34	(\$683.46)
1.5	(\$11,416.73)	5	1	4	20.00	\$1,042.80	(\$7,703.78)	\$1,042.80	(\$3,114.88)	0.33	0.08	(\$2,283.35)
1.25	(\$13,863.80)	7	2	5	28.57	\$1,867.25	(\$7,703.78)	\$1,455.03	(\$3,354.77)	0.43	0.17	(\$1,980.54)
1	(\$18,769.15)	12	4	8	33.33	\$1,867.25	(\$7,703.78)	\$1,015.68	(\$2,853.98)	0.36	0.18	(\$1,564.10)
0.75	(\$25,169.08)	21	8	13	38.10	\$1,867.25	(\$7,703.78)	\$978.43	(\$2,538.19)	0.39	0.24	(\$1,198.53)
0.5	(\$17,508.52)	53	24	29	45.28	\$5,423.68	(\$7,703.78)	\$1,421.12	(\$1,779.84)	0.80	0.66	(\$330.35)

Returns are generally negative across the board. More so above 0.5%. Using 0.75% as a test sample I looked out X days to see results:

SPY gaps lower by 0.75% and closes positive on the day by at least 0.75%.												
Buy on close. Sell X days later. \$100k/trade. 1994-present.												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
10	\$7,123.43	16	11	5	68.75	\$5,261.19	(\$5,110.71)	\$2,149.93	(\$3,305.16)	0.65	1.43	\$445.21
9	\$4,801.51	16	11	5	68.75	\$4,319.59	(\$7,087.58)	\$1,937.95	(\$3,303.19)	0.59	1.29	\$300.09
8	\$6,540.22	17	11	6	64.71	\$5,514.32	(\$7,889.26)	\$2,177.60	(\$2,902.22)	0.75	1.38	\$384.72
7	\$10,262.08	17	11	6	64.71	\$4,707.64	(\$7,561.30)	\$2,363.56	(\$2,622.84)	0.90	1.65	\$603.65
6	\$6,685.19	19	11	8	57.89	\$4,811.10	(\$8,517.85)	\$2,637.05	(\$2,790.29)	0.95	1.30	\$351.85
5	(\$6,889.14)	19	10	9	52.63	\$7,631.40	(\$11,633.47)	\$2,312.90	(\$3,335.34)	0.69	0.77	(\$362.59)
4	(\$11,333.90)	20	9	11	45.00	\$7,370.70	(\$10,330.74)	\$2,674.36	(\$3,218.47)	0.83	0.68	(\$566.70)
3	(\$13,375.84)	21	9	12	42.86	\$5,984.25	(\$7,379.10)	\$1,845.16	(\$2,498.52)	0.74	0.55	(\$636.94)
2	(\$25,169.08)	21	8	13	38.10	\$1,867.25	(\$7,703.78)	\$978.43	(\$2,538.19)	0.39	0.24	(\$1,198.53)
1	(\$11,106.28)	21	9	12	42.86	\$1,834.83	(\$5,238.25)	\$915.76	(\$1,612.34)	0.57	0.43	(\$528.87)

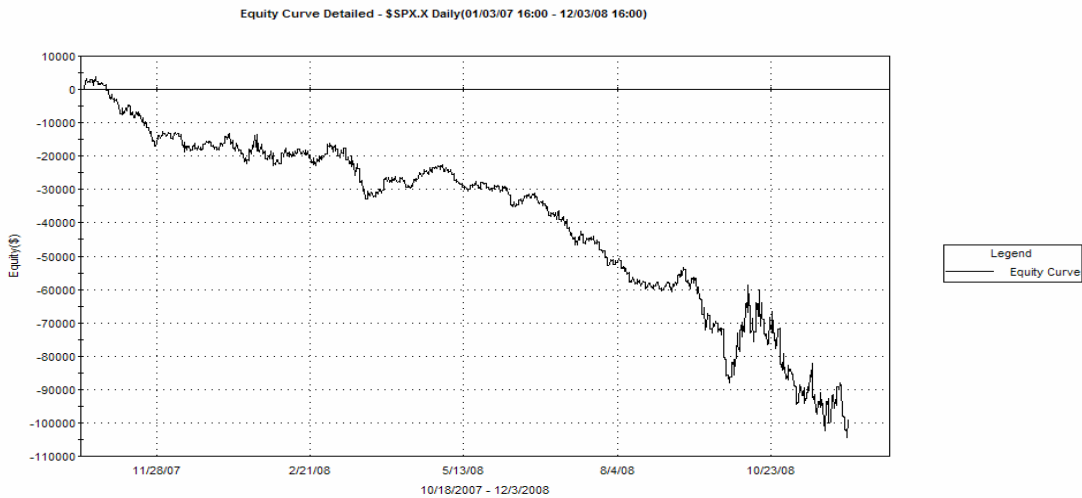
Not seen in the table above is that 77% of instances closed below the close of the trigger day within the next 2 days. Looking out 7 days 90% posted at least 1 close below the trigger close. If you increase the requirements to a 1% gap and a 1% higher close then 11 of 12 would have posted a close below the trigger day close within the next 3 days. Overall there appears to be a fairly strong tendency to pull back after such bars occur. The pullback is often short-lived though.

Once again we have the simple system that looks for two positive closes in this choppy environment. [This system was originally publish on August 28<sup>th</sup>](#) on the blog and has looked to take advantage of the [extremely choppy market conditions that have persisted](#) over the last year and a half. It looks to go short any time the S&P closes higher 2 days in a row. The position is covered at the 1<sup>st</sup> profitable close or at the close of the 4<sup>th</sup> day after entry if it is still not profitable. The last signal was on 11/24. It took the full 4 days before making 4.2% thanks to Monday's large selloff. Below is an updated performance report for the system dating back to June 1 of 2007:

TradeStation Performance Summary				Expand ▾
All Trades				
Total Net Profit	\$53,417.37	Profit Factor	14.18	
Gross Profit	\$57,469.36	Gross Loss	(\$4,051.99)	
Total Number of Trades	50	Percent Profitable	96.00%	
Winning Trades	48	Losing Trades	2	
Even Trades	0			
Avg. Trade Net Profit	\$1,068.35	Ratio Avg. Win:Avg. Loss	0.59	
Avg. Winning Trade	\$1,197.28	Avg. Losing Trade	(\$2,026.00)	
Largest Winning Trade	\$8,783.02	Largest Losing Trade	(\$3,230.74)	
Max. Consecutive Winning Trades	20	Max. Consecutive Losing Trades	1	
Avg. Bars in Winning Trades	2.77	Avg. Bars in Losing Trades	5.00	

This isn't a system that will perform well in a strongly uptrending market, but the choppy and bearish conditions have combined to make it a solid method for entry over the last year and a half.

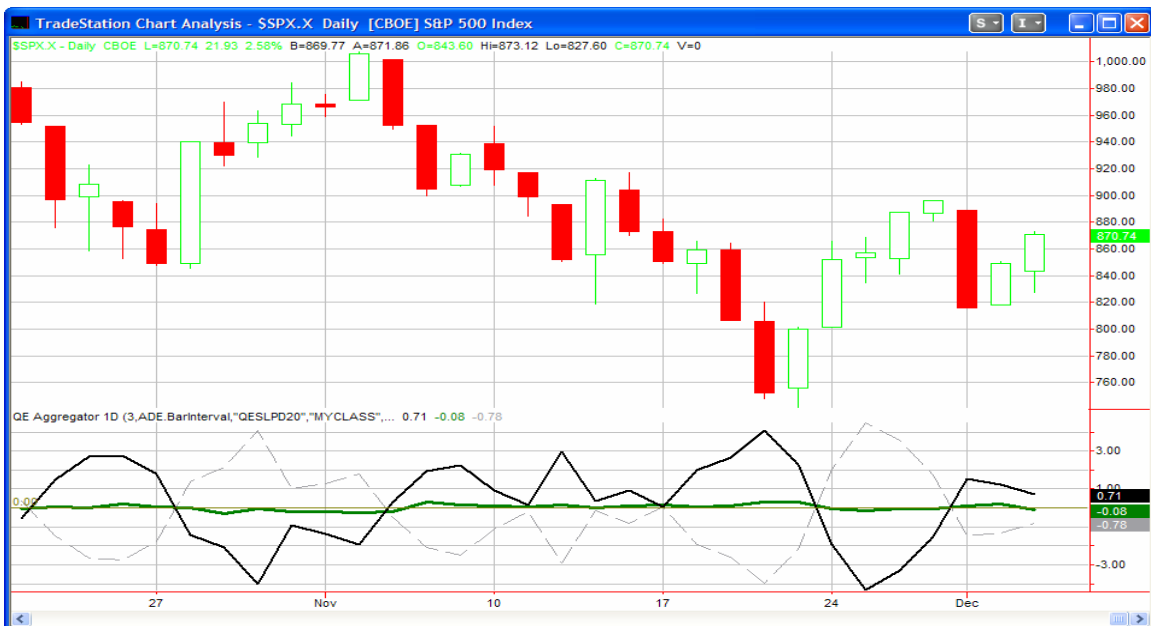
An updated look at the “Trend vs. Chop” chart (click here for details) shows that Monday and Tuesdays extreme reversal moves put it back at new lows. In other words, the environment remains choppy.



A potential market positive is the fact that the Volume Spyx indicator has closed higher for the last 2 days while the market has also. I’ll be showing a study on this in the blog tomorrow. It’s appears to provide a slight bullish edge. It is significantly better than the alternatives of 1 or 2 days the Spyx dropping lower. It’s only happened 4 times in the last year and a half, though and results were mixed. I won’t be including it among the active studies because the bullish edge is not clear. It is perhaps a ray of hope for the current move.

Until proven otherwise, though. I will treat chop as the dominant market characteristic and will look to take advantage of it.

The [Aggregator](#) chart is updated below:



Tonight's studies have dropped the green Aggregator line back below zero. The black differential line remains above zero showing the market has underperformed expectations over the last 3 days. Monday's 9% drop is the sole reason for this and it will drop out of the calculation tomorrow, forcing the differential line to plummet absent another sharp drop on Thursday. I am going to use tomorrow to try and gain a favorable short entry. I will scale in again as described in the "trade idea" section below.

***Intermediate-term Outlook (2 weeks – 2 months)–slightly bullish -updated 12/1***

The market has managed to bounce strongly from levels that were [extremely oversold based on historical measures](#). Most of the time in the past this has led to continued follow through over the next few weeks or months. This is the third try for such a rally since early October. The first two attempts quickly died out.

The S&P has already rallied over 19% off its lows. It rallied about 12% just last week. In the November 2nd Letter I showed a study that compared the 1<sup>st</sup> week gains of the S&P off the lows with the 1<sup>st</sup> week gains of the IBD 100. The IBD 100 is an active index whose components change from week to week. It is compiled and tracked by Investors Business Daily and it is supposed to represent leading stocks.

The premise of the study was that outperformance of the S&P 500 over the IBD 100 could suggest a rally driven by short-covering as laggards were outperforming leaders. What was found out was that this kind of short-covering is desirable at the beginning of a new rally. Those attempts that saw the IBD 100 lag in week one actually performed quite a bit better than those that didn't. While the October attempts struggled I'd still consider it a good sign that the S&P has performed so strongly as compared to the IBD 100 over the last week.

Another notable occurrence from last week is the possible direction change in the trend vs. chop chart, which can be found on the website [by clicking here](#). While it's too early to know for sure, it appears the trend vs. chop chart is also attempting to put in a bottom. This would signal a character change for the market as the environment could move from one where directional moves are more often reversed strongly on a daily basis to one that favors follow-through day to day. The last such attempt to move from a choppy to a trendy environment was in early October and that reverted to choppy very quickly. I'll continue to keep an eye on this attempt.

Basically I'm seeing evidence that would suggest the market got so overdone and has bounced so violently that it is likely to put in a rally that could last from a few weeks to a few months. Unfortunately many of the same indications were given at the October rally attempts. Should the pullback manage to put in a higher low, which seems likely at this point, I will likely begin to trade with a bit of a bullish bias.

**Catapult and Capitulative Breadth Statistics**

[\(Catapult Presentation Part 1\)](#) [\(Catapult Presentation Part 2\)](#)

***Open Catapult Trades***

MDT is still officially open although we exited a while ago.

### **Catapult for ETF's Trades**

None new

### **Broad Market Large Cap CBI – 1 (MDT)**

### **Sector CBI Breakdown (% of stocks with active catapult triggers within each sector.)**

<b>Index</b>	<b>ETF</b>	<b>CBI %</b>	<b>Index</b>	<b>ETF</b>	<b>CBI %</b>
DJ US Broker Dealers	IAI	0.00	DJ US Energy	IYE	2.33
DJ US Insurance Index	IAK	0.00	DJ US Financial	IYF	0.34
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.00
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	2.82
DJ US Oil&Gas Expl & Prod	IEO	3.45	DJ US Industrial Sector	IYJ	0.00
DJ US Oil Equip & Svcs	IEZ	1.92	DJ US Consumer Goods	IYK	0.68
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	1.35
DJ US Healthcare Providers	IHF	2.04	DJ US Real Estate	IYR	1.22
DJ US Medical Devices	IHI	2.44	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	0.00	DJ US Technology Sector	IYW	0.50
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	1.75	Nasdaq 100	QQQQ	2.00

### **Additional New Trade Ideas**

*SPY – short ¼ position @ \$89.50 limit. If not filled, short @ \$87.32 limit on close.* With choppy conditions and a bearish short-term outlook I'm looking to get some short exposure. The intraday limit order has been placed about ¾% below the recent swing high. See short-term outlook above for further elaboration on market bias.

### **Active Trades Table**

None.

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